

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 OCEAN PALACE, INC.) Account Number: SR GH 99-451458
 6) Case ID 425058
 6 Petitioner) San Jose, Santa Clara County

7 Type of Business: Restaurant

8 Audit Period: 10/1/03 – 9/30/06

9 Item Disputed Amount

10 Unreported taxable food sales \$435,668

	<u>Tax</u>	<u>Penalty</u>
12 As determined	\$65,456.89	\$6,545.67
13 Adjustment – Appeals Division	<u>-29,514.19</u>	<u>-6,545.67</u>
13 Proposed redetermination and protested	<u>\$35,942.70</u>	<u>\$ 0.00</u>
14 Proposed tax redetermination	\$35,942.70	
15 Interest (tax paid in full 1/28/08)	<u>8,708.30</u>	
15 Total tax and interest	\$44,651.00	
16 Payments	<u>-44,651.00</u>	
17 Balance	<u>\$ 0.00</u>	

18 UNRESOLVED ISSUE

19 **Issue:** Whether additional adjustments are warranted. We conclude that no further
 20 adjustments are warranted.

21 Petitioner operated two restaurants, “Ocean Palace” and “Ocean Delight Seafood.” After the
 22 audit period, on January 31, 2008, petitioner sold Ocean Palace. This was petitioner’s first audit. For
 23 the audit, petitioner provided federal income tax returns (FITR’s), bank statements, guest checks, daily
 24 sales summaries, and partial purchase invoices. The Sales and Use Tax Department examined
 25 petitioner’s bank deposits and noted that it did not have cash deposits in May 2004, January 2006, and
 26 September 2006, which suggested not all sale proceeds were deposited in petitioner’s bank account.
 27 The Department stated that the achieved markups of 131 percent, 106 percent, and 122 percent on the
 28 FITR’s for the years 2003, 2004, and 2005, respectively, were low for this type of business because

1 typically they are in the range of 200 to 300 percent. Therefore, the Department did not accept the
2 gross receipts that were reported on the FITR's, and decided to establish petitioner's sales based on an
3 observation test.

4 The Department conducted an observation test consisting of three days at one location and two
5 days at the other: Thursday, January 11, 2007, at Ocean Delight Seafood, Wednesday, January 17,
6 2007, and Sunday, April 29, 2007, at both Ocean Delight Seafood and Ocean Palace. The Department
7 initially used the sales from Sunday, April 29, 2007, to represent petitioner's weekend sales on Friday,
8 Saturday, and Sunday. Based upon the observation test, the Department established that credit card
9 sales represented 63.94 percent of total sales. The Department compiled the credit card deposits for
10 the audit period, adjusting for tips and sales tax included, to compute credit card sales. The credit card
11 sales amount was then divided by the credit card ratio of 63.94 percent to establish audited taxable
12 sales. Upon comparison to reported taxable sales, the Department initially calculated that petitioner
13 had underreported its taxable sales by \$793,416.

14 Petitioner contends that the observation test used by the Department does not accurately reflect
15 petitioner's sales for the audit period. Petitioner states that the Wednesday, January 17, 2007 sales
16 observed by the Department at Ocean Palace were atypically high due to a church group meeting that
17 ate at the restaurant on that day. Petitioner also contends that the Department's application of a Friday,
18 Saturday, and Sunday weekend rate rather than a Friday and Saturday weekend rate resulted in a
19 higher taxable measure than actually applicable.

20 After the appeals conference, the Department recalculated the taxable measure by changing the
21 weekend rate to include only Saturday and Sunday, calculating a reduced underreported taxable
22 measure of \$435,668. Petitioner continues to contend that the amount of sales observed on
23 Wednesday, January 17, 2007, was higher than normal due to the church meeting eating at the
24 restaurant on that day. Petitioner provided a schedule of its Wednesday sales from 2006 and 2007 for
25 Ocean Palace to show that the average sales were not over \$1,000, and a schedule listing the daily sales
26 in 2006 and 2007 for both restaurants. The Department responded that the documents cannot be
27 verified because they are not supported by source documents such as guest receipt and credit card
28 receipt slips.

